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ADEQUACY OF THE CUSTOMS REVENUE SYSTEM.

I.

THERE are, at least, three distinct questions to be considered regarding any system of taxation—is it adequate? is it just? is it economical? From the popular stand point justice is the predominant consideration. In popular discussions, in newspapers and journals, the principles of uniformity and universality are topics of perennial discussion; and, on every hand, the relative merits of progressive and proportional taxation are vehemently set forth. Each tax and each system of taxation is thoroughly scrutinized by the public and unconditionally approved or condemned as it seems to conform to, or violate the ideals of justice. This ferment is rapidly taking definite form. Everywhere the public is clamoring for modifications of existing tax systems, which shall bring them more nearly into conformity with the popular ideals. Despite this clamor, however, the feasibility of such changes deserves the most careful examination. The importance of a proper regard for the principles of justice will not, of course, be denied, but this should not be allowed to obscure the fact of the existence and practical importance of fiscal and economic principles. It must be remembered that, after all, absolute justice in taxation is but an ideal conception, so remote from the possibility of practical attainment, that good authorities are still in controversy over the question—what constitutes, theoretically, a just distribution of taxation? Really, then, much the greater part of the current discussion of justice in taxation is in the air.

The positive result of this popular outcry is to cover up the real kernel of the tax question. To discover this, one need merely ask—what is the object of taxation? Manifestly it is income. To be sure, the aim of the financier is to obtain the necessary income, and, at the same time, to inflict upon individuals as little injustice as possible. But even at the expense of great

injustice the income must be obtained. Fiscal considerations must always outweigh considerations of justice. A moment's thought will convince any one of the truth of this proposition, in spite of its apparent harshness. It rests on two or three political axioms: Man is necessarily social; he cannot live apart nor without some social organization; the government is the social instrument; it is the necessary means of satisfying his higher needs. Justice, itself, for example, can be attained by the individual only through the efficient working of the governmental machinery. No teaching of history, however, is clearer than that, not only is the life of a government ultimately dependent on the adequacy of its income, but good government is from year to year bound up with good finance; "without sound finance no sound government is possible." The fiscal principles then must be regarded as the most important of all the principles of finance. This view has the sanction of the best authorities. Mr. Bastable, the leading English writer on Finance, evidently adopts it when he remarks that—"Productiveness and a tolerable approach to just distribution are the two essentials of taxation." Much more explicit is the statement of Professor Adolph Wagner, who, while emphasizing throughout his writings "social justice," says: "It is not customary to place them [the fiscal principles] among the highest tax principles, but this is right and positively necessary. They are the highest, even outweighing in importance the principles of justice."¹

The weight of popular criticism on the ground of injustice has for some time past been consistently directed against indirect taxation. It was, partly at least, in response to the popular conviction in regard to the essential injustice of indirect taxation, that the attempt was recently made to incorporate permanently in our national revenue system some form of the income tax. As customs duties are a form of indirect taxation, it is assumed that they impose disproportionate burdens upon the great mass

¹ *Finanzwissenschaft*, Vol. ii. p. 304. Quotations upholding this position might also be taken from the works of Nasse, Humboldt, Leroy-Beaulieu, and many other prominent theoretical and practical writers. In fact this view of the importance of the fiscal principles is regarded by many high authorities as almost axiomatic.

of poorer contributors. Regardless then, of the effect upon national income, the public demands that the system be modified by the introduction of a tax bearing most heavily upon rich contributors. But it has been seen that the best judgment requires that the efficiency of any tax system be, first of all, tested by the fiscal principles. Its satisfying the demands of these establishes a strong presumption in its favor, which can be repelled only by proving a flagrant violation of the other tax principles. If, in other words, the customs revenue system possesses a high degree of fiscal adequacy, that is, if the income received from it habitually satisfies the government demands, only proof of great injustice can sanction its modification.

The present state of affairs, in which an attempt is being made to modify radically, the customs system, demands, then, a thorough examination of that system on the grounds of fiscal efficiency. In the following pages such an examination will be attempted. On account of the practical importance of the question, the *a priori* verdict, which indeed weighs against the system, will be wholly discarded and the discussion will take the form of an inductive investigation. The field for this investigation will be the financial history of the United States. The discussion will naturally divide itself into two parts; in the first, the actual workings of the system will be tested by fiscal criteria; in the second, the effect of any disturbing circumstances peculiar to the United States will be considered, and an attempt made to arrive at the net result of both examinations.

II.

It will be well before proceeding with the historical discussion, (1) to define clearly the criteria by which it is proposed in the following pages to test the customs revenue system, (2) to determine the period in American history over which the discussion may properly extend, and (3) to indicate briefly the data appropriate to the discussion and the method of procedure to be followed.

(1) As indicated in the foregoing paragraphs, the principles

of fiscal adequacy will be the criteria here employed. These principles are deduced from the general character of the public economy. In order to attain perfect adequacy the government needs must always be met by revenue both as to time and amount.¹ Now under the ordinary circumstances, expenditure—the measure of government needs—is reasonably uniform from year to year. Income must, then, ordinarily be sufficient but no more than sufficient, to satisfy this uniform demand. As, moreover, government demand rarely varies with the variation in industrial and commercial conditions the revenue should also be derived from a stable source. Further, as the very nature of government operations constantly expose it to sudden and unforeseen expenditures, it follows that the public income should possess a high degree of flexibility. Sufficiency, stability, and flexibility are then the principles of fiscal adequacy. Definitely stated, sufficiency requires that the income be ordinarily commensurate with the demands of government; stability, that the income resist all forces, not of governmental origin, tending to make it vary; and flexibility, that it be capable of accommodation, with precision and rapidity, to changes in the government demand.

(2) Having defined the fiscal principles, the next step, preliminary to the main discussion, should be to determine under what circumstances these criteria may be used to test the adequacy of the customs revenue system. Obviously, it is only when the income from taxation violates these criteria, from causes inherent to the employment of the form of taxation in question, that inferences can be drawn from these violations in regard to its general fiscal adequacy. But violations of the fiscal principles often arise solely from incidental or non-inherent causes. This occurs particularly when a form of taxation is used simply as a part of a general system. It is then usually employed on account of its excellence in one respect, *e. g.*, flexibility, and, the sufficiency and stability of the whole system being

¹ There must be neither surplus nor deficit at any time. For, while deficit leads to debt, surplus leads to overestimation of the tax-paying capacity of a people and extravagant expenditure.

secured by the use of other taxes, little effort is made ordinarily to render the income from this source either abundant or stable. Under such circumstances the violation of the principles of sufficiency and stability may arise from administrative neglect. It follows, that a discussion in which the general fiscal adequacy of a source of taxation is to be determined inductively by means of these principles, must be confined to periods of history in which that source was employed as the basis of a general revenue system, responsible alike for the sufficiency, flexibility, and stability of the whole system. It becomes necessary, then, to show that customs duties have been thus employed in the United States and to define clearly the period in which they have served as our national system of taxation. Fortunately the task is not difficult.

A system of duties on imports for the support of the national government was established by the first Congressional revenue act under the constitution of 1789. It seems to have been the popular desire, at that time, that customs duties alone should supply the Federal revenue. But distrust, notably on the part of Hamilton, of the ability of this source to supply fully the fiscal needs of the government, led to the establishment also of a system of internal revenue duties. These two systems were on trial together for a decade. The result was definite. Though more than eighty-eight per cent. of the tax income was derived from import duties, that source continued to be regarded with favor by the people, while the internal revenue duties were steadily opposed. Nor was the opposition merely passive. In the case of the Whiskey Rebellion, it developed into armed resistance to Federal authority and, rapidly increasing in force, assumed at length the proportions of a National political issue. As such it accomplished a tax revolution. In the campaign of 1801 the maintenance of internal duties was one of the objections urged against Federalist rule. The triumph of the Republicans was immediately followed, as a political necessity, by the abolition of the internal taxes. This verdict of the people was final; it definitively established customs duties alone as the American

system of national taxation. From that time until the end of the civil war, resort was had to other forms of taxation "only on occasions of special exigency,"¹ marking the breakdown of the customs tax system.

Since the civil war, indeed, the internal revenue duties imposed, during that emergency, to supplement the income from import duties have been in part retained, but with no intention of displacing the traditional American system. On the contrary that system has been constantly strengthened. The internal duties may be regarded as taxes of convenience, retained simply to bolster up the regular tax system. The fairly steady stream of income flowing from them reduces, to that extent, the amount of revenue to be derived from import duties. But in no way does it remove from the customs revenue system the responsibility for adequacy. Customs duties then, may, with propriety, be subjected to the test of adequacy, as the American system of taxation, from the tax revolution of 1802 to the present time.

(3) It now remains, before entering upon the historical discussion, merely to indicate briefly the data necessary for the examination and the method of procedure. The most essential data for the inductive test about to be attempted are the figures of government expenditure, and of the income from customs duties in the United States, during the whole period under discussion. These figures have been collected and will be found in tables in the Appendix. Further, because of defects in the sources from which it was necessary to obtain these data,² and also, because of the intimate relation existing between customs revenues and imports, the amounts of total and of dutiable imports have been added to the tables. For convenience in use all these figures have been incorporated into two charts (see below). In the first of these charts is represented the actual values of total imports and customs revenues from 1790 to 1893 inclusive, and the value of dutiable imports from 1821 to 1893. In the second chart is represented the per cent. of customs revenues to net

¹ Adams' *Life of Gallatin*, p. 294.

² See Appendix I.

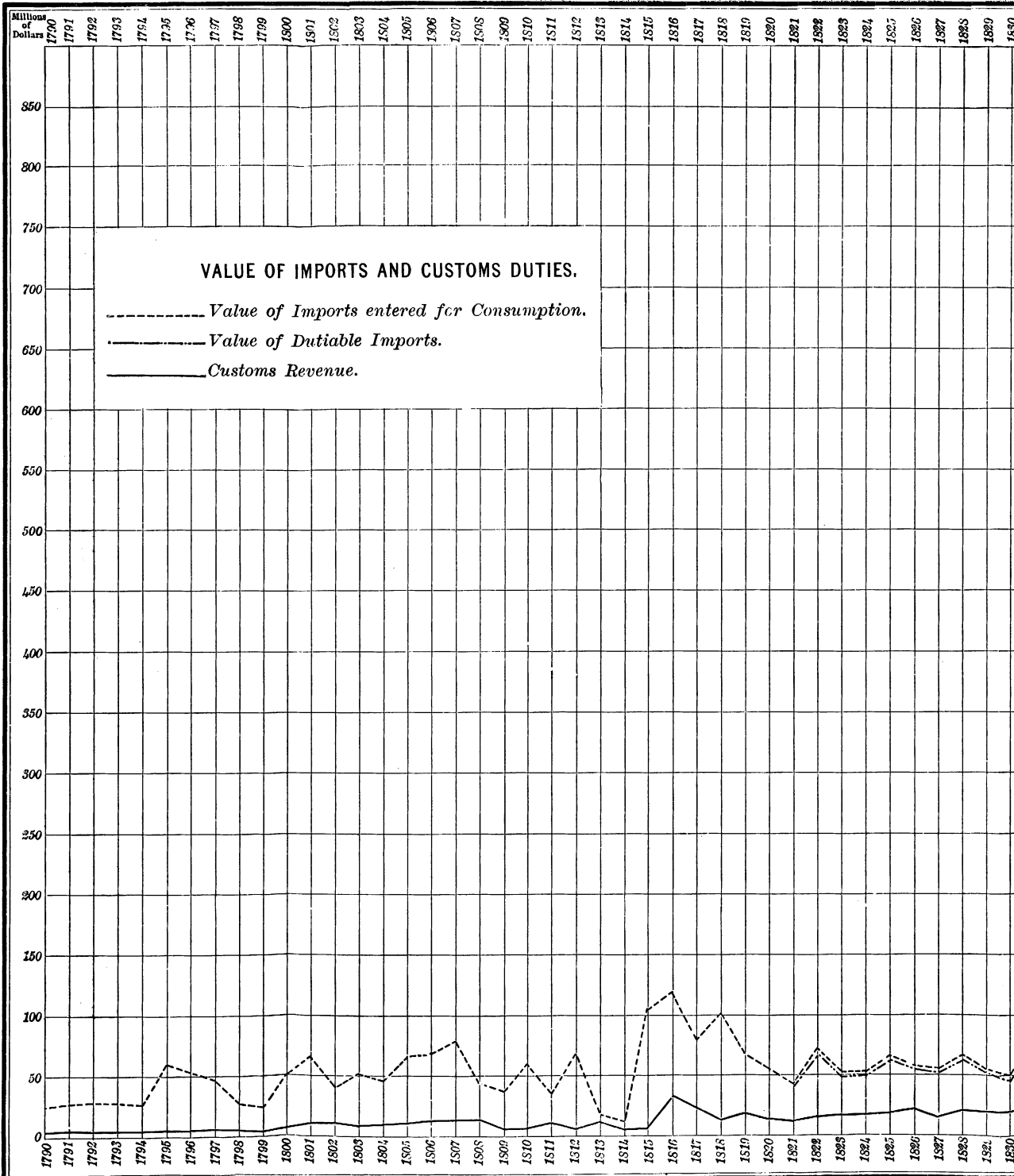
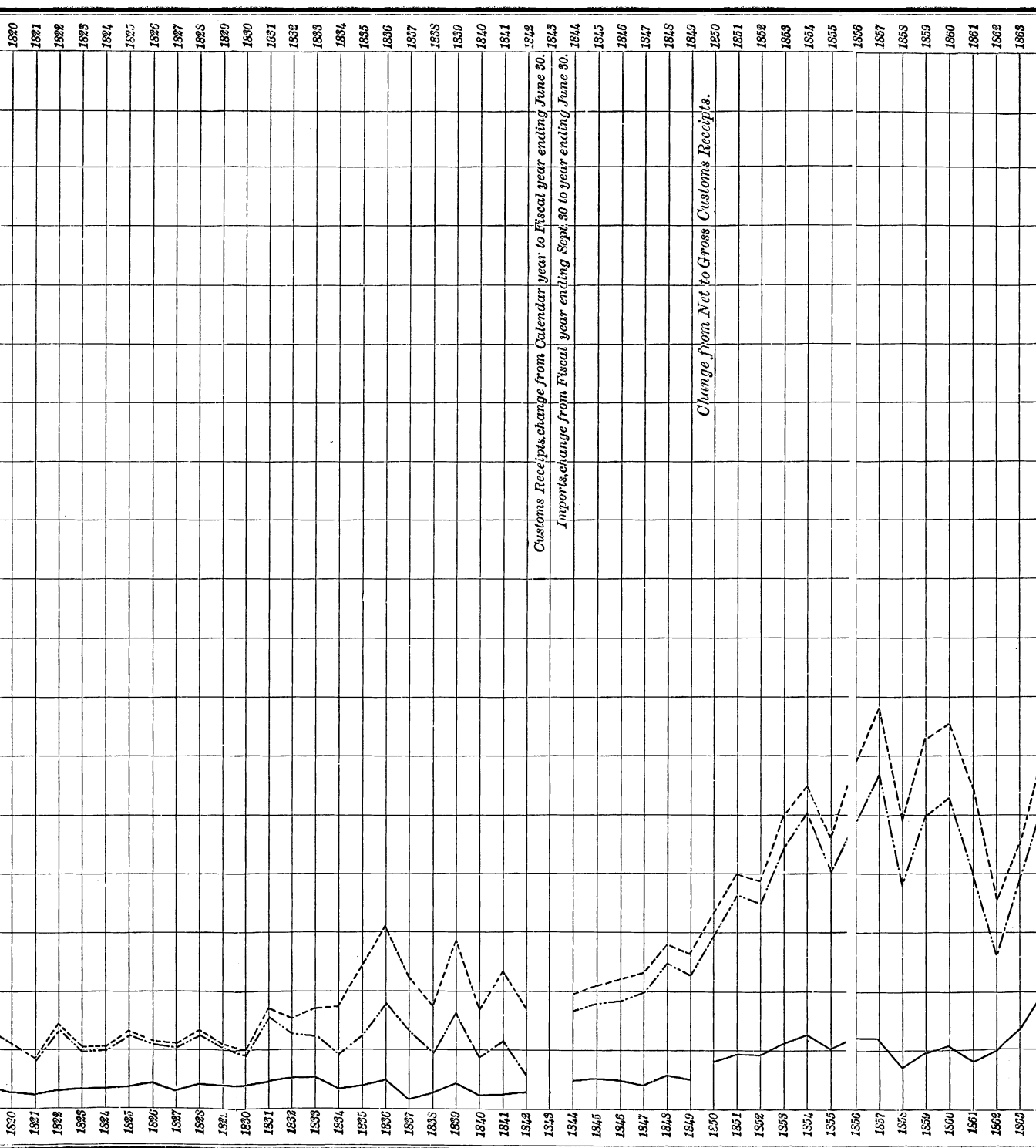
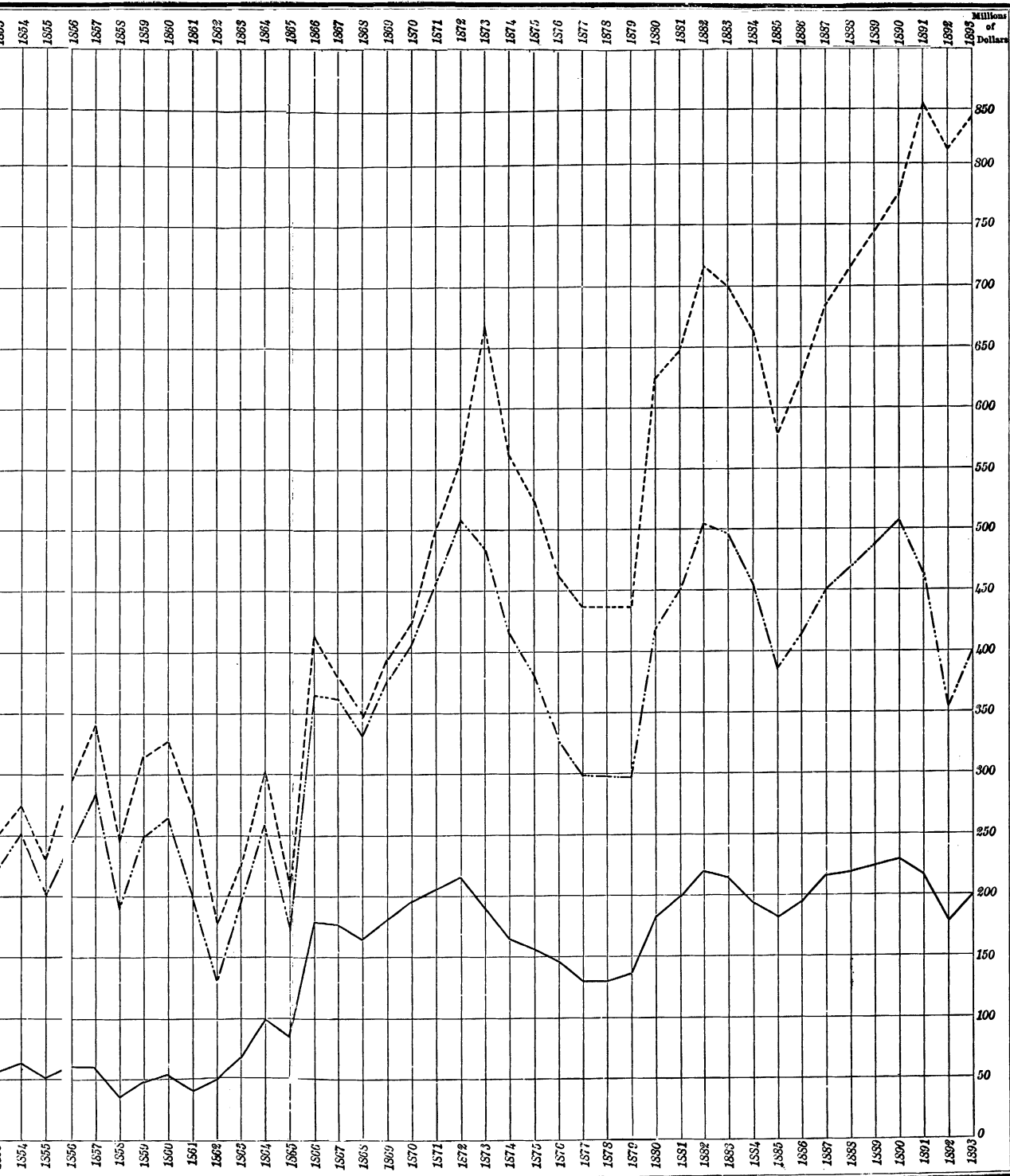


CHART I.





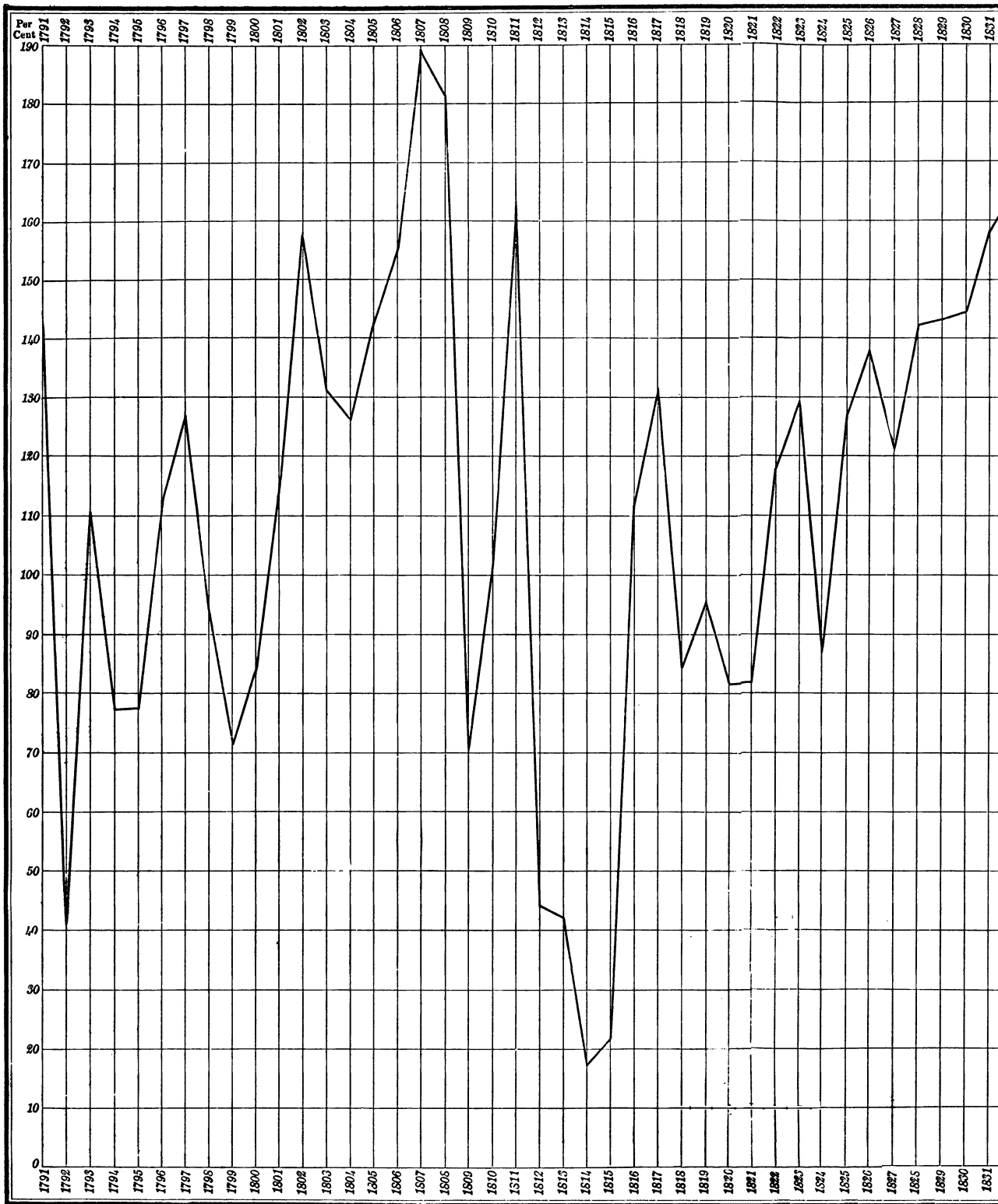
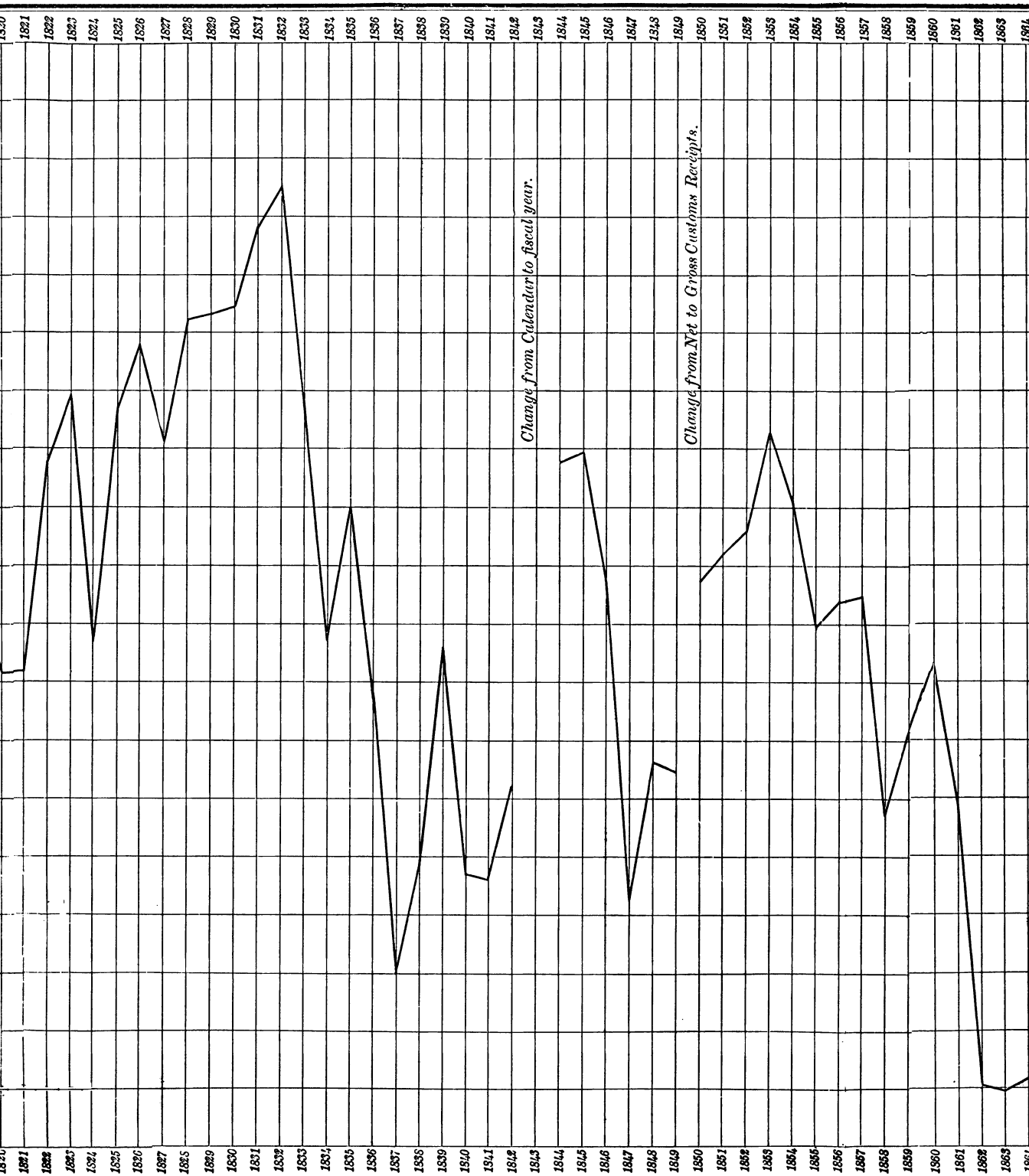
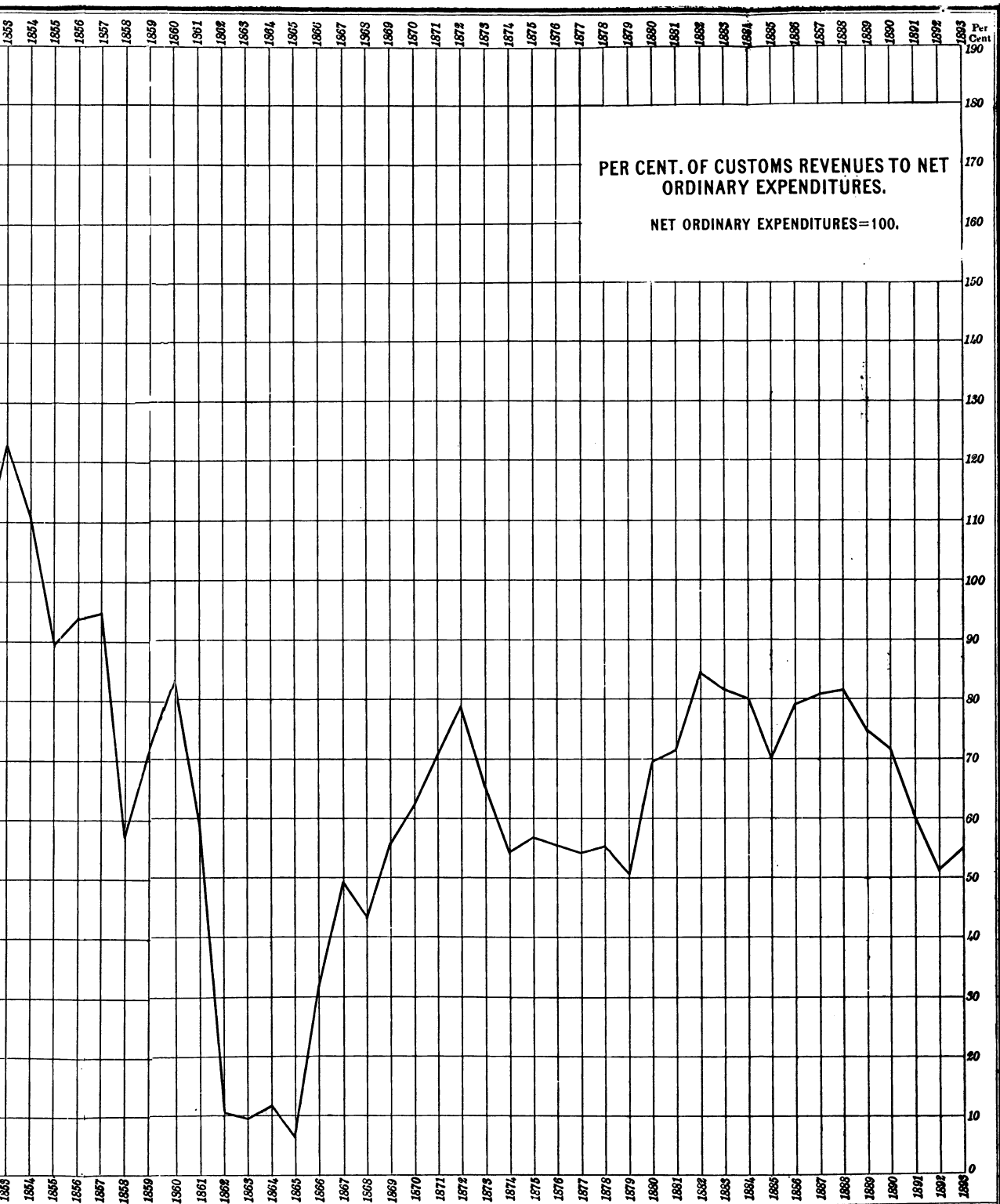


CHART II.





ordinary governmental expenditures from 1790 to 1893. It will be the aim of the following discussion to interpret these charts by the aid of the events of contemporaneous history and the examination will be separated into several convenient parts, corresponding to the periods into which our history naturally divides itself when viewed with reference to political and industrial conditions.

I. The years from the adoption of the Constitution of 1789 to the outbreak of the War of 1812 form a distinct period in the national and industrial development of the United States. The conditions were those of a young but vigorous agricultural and commercial nation subjected to strong foreign influence. The current national expenditure, though varying from year to year was never excessive. Taxation was moderate as proved by the general prosperity of the people, and the rapid payment of the public debt. Under these conditions, the income from an efficient system of taxation, ought not to have violated to any great extent the principles of fiscal adequacy. A glance at Chart II., however, shows that throughout the period, and especially in the last decade when customs duties were the only source of public revenues, the income did seriously violate these principles. While the revenue was in the main much more than sufficient to supply current fiscal demands, its great and rapid fluctuations, when compared with government expenditures, rendered it an extremely variable basis upon which to place public finances. Chart I. clearly shows the reason for this instability. Imports, upon the value of which customs revenues were dependent, reflected, not the demands of our government, but every marked change in European diplomacy and war.

Previous to the year 1802 the general state of European war had proved, in the main, advantageous to our commerce. Still the instability of customs revenues had been remarkable. Starting with a production in 1791, 41.5 per cent. above the government expenditure, the income from this source fell the next year to more than 58 per cent. below public expenditure, rose again in 1793 to 110.3 per cent., fell immediately to 76.2 per

cent., and then rose with fluctuations violent but less extreme till, in 1802 when the internal duties were discarded, it stood at 155.9 per cent. or more than three millions above the demand for current expenditure. The stability of public income was not increased by basing the national revenue system upon customs duties alone. The temporary cessation of hostilities in Europe in 1802 was accompanied by an immediate fall in the value of imports to \$40,558,000 as compared with \$64,720,000 in the previous year. The renewal of European wars again produced a gradual increase of American commerce, until in 1807 the value of imports had risen higher than ever before, exceeding \$78,000,000, while the revenue from customs duties was 89.6 per cent. in excess of ordinary public expenditures. This surplus revenue, though in general indicating an unsound condition of the finances, did not prove burdensome to the treasury at the time, as an outlet for it was provided in the payment of the revolutionary war debt. The productiveness of taxation therefore, gave rise to high expectations and led so conservative a financier as Mr. Gallatin to believe that the customs revenue system would prove an adequate basis in case of foreign war. In 1806 he raises the question whether some mode may not be devised to provide for the final and complete payment in a short period of the public debt.¹ The next year he estimates that the surplus in the treasury at the end of 1808 will amount to \$8,000,000, and that "an annual unappropriated surplus of at least \$3,000,000 may henceforth be relied upon with great confidence."² But in this he was quite misled. Already that series of events, foreign in origin, had commenced which, though not depriving the American people of the means for satisfying government needs, were destined speedily to all but annihilate American commerce and thus cut off from the government its source of supply. The Berlin and Milan decrees of Napoleon followed by the British orders in council, the expiration of Jay's treaty, and Jefferson's unfortunate imposition of the embargo brought about

¹ *Report of the Secretary of the Treasury, 1806, Finance Report, vol. i. p. 336.*

² *Report of the Secretary of the Treasury, 1807, Finance Reports, vol. i. p. 359.*

an immediate falling off in the volume of American imports from \$78,856,000 in 1807 to \$43,992,000 in 1808 and \$38,602,000 in 1809. The suspension of commerce meant the impairment of the revenue from customs duties. From 1807 to 1809 the income from this source fell from \$15,845,000, or 89.6 per cent. more than was called for by current government needs, to \$7,257,000, a little more than 70 per cent. of the government expenditures. The surplus for which Mr. Gallatin had been seeking employment was immediately swept away. In his report for 1808 the Secretary's tone has entirely changed. "If the embargo and the suspension of commerce shall be continued," he writes, "the revenue arising from commerce will in a short time entirely disappear. In case of war some part of that revenue will remain; but it will be absorbed by the increase of public expenditures. In either case, new resources to an unascertained amount must be resorted to."¹ From this time to the end of the period in 1812 a series of rapid changes in the aspect of foreign affairs was faithfully reflected by fluctuations in the source of revenue. In 1808 England opened the ports of Spain and Portugal, and early in 1809 the embargo was suspended—importations responded in 1810 by a rise from \$38,602,000 to \$61,008,000. Napoleon, in 1810, seized the American shipping in European ports, and the embargo was reënfined in the same year as regarded England—importations fell in 1811 to \$37,377,000. Shortly after, Russia and Sweden opened their ports to American shipping in defiance of the Berlin and Milan decrees—imports rose rapidly to \$68,534,000.

A more comprehensive idea of this period may perhaps be obtained from an examination of the charts and tables than from the previous discussion. But such an examination serves only to strengthen the evidence revealing the inadequacy of the customs revenue system. From Chart II. it will be seen that in the twenty-one years here included, though the revenue was on the whole much above government expenditure, yet it fell below that amount no less than nine times—a most remarkable exhi-

¹ *Report of the Secretary of the Treasury, Finance Reports*, vol. i. p. 377.

bition of instability. Further, after 1802, when customs became the sole source of revenue, the public income, as shown by the tables, ranged from 30 per cent. below to 89 per cent. above expenditures; yet in one year only, did it approach nearer than 27 per cent. above or below that amount. In a word, the revenue seemed utterly uncontrollable either by reduction when it was too large or by increase when it was too small. Taken as a whole, then, the examination of this period indicates clearly that when the commerce of a nation is exposed to serious disturbances, on account of foreign influence, great instability in the revenue derived from this source is the inevitable consequences, and disordered finances the result. Under such circumstances it must be extremely dangerous to base the public finances upon customs duties alone.

2. With little change in industrial conditions, the United States passed from the period of foreign influence into a period of foreign war. Peace was formally abrogated at about the close of the fiscal year 1812, and normal conditions were not restored until near the end of the fiscal year 1816. Roughly speaking, these dates mark the limits of the war period. Were it reasonable, during this time, to judge of the adequacy of the customs revenue system by means of a simple comparison between the income from import duties and the necessary expenditures of the government, no elaborate discussion would be necessary in order to reach a very definite conclusion. The great depression of the broken line on Chart II. clearly and conclusively indicates the utter failure of the customs revenue to support the government adequately. It must be borne in mind, however, that this period was a crisis in the life of the nation when it may be doubted whether the current national income was sufficient to satisfy both the total wants of the government and the imperative individual needs of the people. No tax system in such a case could be required to furnish the whole of the necessary government income.

This fact was recognized at the time, and influenced the financial plan of the war. Mr. Gallatin, Secretary of the

Treasury, in outlining this plan, calculated that taxation might be safely depended upon to defray the ordinary expenses of the peace establishment, together with the interest on the public debt, and that, with this tax income as a basis, the extraordinary expenses might be defrayed by loans, without injury to the credit of the nation. In pursuit of this policy, he proposed that the whole of the tax income should, as heretofore, be drawn from customs duties. These calculations seem to have been reasonable. Imports, though varying, had risen in 1812 to more than \$68,000,000—an ample source from which to obtain the peace revenue—while there was an abundance of loanable capital in the country.¹ The war policy, then, was rational. Further, it was conditioned on the character of the revenue from custom duties. Unless, therefore, it can be shown that the nation was exhausted or the people disaffected, the adequacy of the customs revenue system during this period is to be judged by the success of the war policy.

From the outset, the financial operations of the war were inadequately supported by the tax revenue. In accordance with his plan Mr. Gallatin had recommended that customs be immediately increased 100 per cent. June 30, 1812, therefore, duties were doubled, but the anticipated increase of revenue was not forthcoming. The income was, indeed, larger for the calendar year 1813 than in the years preceding, owing to the great amount of imports in 1812, but it fell immediately thereafter far below the peace level, and during the continuance of the war remained utterly insufficient and wholly inflexible. Nor could the result have been otherwise. For the amount of imports progressively fell as public expenditure rose, until, in 1815, the total value of imported merchandise was less than the ordinary income from customs duties, and not one-third of the amount of public expenditures. The credit of the government declined almost from the beginning. Of the six government loans only the first

¹ In 1808 Mr. Gallatin said: "The embargo has brought in and kept in the United States almost all the floating capital of the nation, . . . at no former time has there been so much redundant and unemployed capital in the country."—*Report of the Secretary of the Treasury*, 1808, *Finance Reports*, vol. i. p. 377.

was placed at par, though 6 per cent. was offered and various tempting inducements held out to capitalists. The depreciation of the public credit is shown in the discount of 35 per cent. at which 6 per cent. stock was sold in 1814. The successive issues of treasury notes which were resorted to after the fiscal year 1813 also suffered severe depreciation. By 1815, so low had the credit of the nation fallen, that payments in state bank paper, though the banks had suspended specie payment, were universally preferred to payments in the paper of the government.

The failure of the customs revenue system to produce an abundant revenue, and this consequent deplorable state of the public finances, were not due to national exhaustion. The resources of the country were ample,¹ but they could not be reached through the channel of customs duties. Nor, in spite of the opposition of New England, can the fall of public credit be ascribed to the unwillingness of the people to bear further taxation. Secretary Campbell distinctly denied both suppositions,² and his denial is borne out by the fact that the internal duties, reluctantly placed when it became evident that the custom revenue system had broken down, produced a fairly abundant income up to the end of the period. No valid excuse then, for the insufficiency of the public revenue being found in the want of public wealth or the popular support of the government, it must follow that the failure of the financial plan of the war, conditioned as it was upon customs duties, is evidence of the inadequacy of that system of taxation to serve as the source of national income.

The evidence against the customs revenue system furnished by this period is not, moreover, all brought out in the discussion

¹ See *Report of the Secretary of the Treasury* (Jones), 1813, *Finance Reports*, vol. i. p. 491.

² "The resources of the country are not exhausted . . . The promptitude and cheerfulness with which the present taxes are paid, afford the best pledges of the spirit with which the people will meet such demands as the interests and safety of the country may require."—*Report of the Secretary of the Treasury* (Campbell), 1814, *Finance Reports*, vol. i. p. 531.

of the failure of the war policy. The instability of the revenue from import duties was, further, most strikingly illustrated by the events following the close of the war. As soon as the artificial restraints on foreign intercourse were removed, the volume of imports rose to a great height. In 1815 the value of imported merchandise stood at only \$10,645,000; the next year it was \$129,964,000, more than a twelve-fold advance. The one hundred per cent. increase in the rate of customs duties, now that the imperative need for it was past, now that it was too late to save the credit of the nation, became enormously productive. For the year 1816 the customs revenue was five times greater than for 1815, while in 1816 and 1817, together, \$63,589,000 flowed into the treasury from import duties, as against \$13,280,000 in the two years preceding. This remarkable increase of revenue, coming so near the close of the war and yet causing no stay in the progress of the nation, is indicative of the tax income that should have been realized while the war was actually in progress. Had the \$63,000,000 of revenue now received from customs duties been distributed over the three or four preceding years, there is every reason to believe that the war might have been more vigorously prosecuted, the credit of the government sustained and much less public debt incurred.

3. Oppressive foreign influence in the United States disappeared with the war of 1812. A new era was then entered upon, characterized chiefly by vigorous and healthful national growth, the payment of the public indebtedness, and the rise of manufactures. The limits of this period, as distinctly shown in Chart I., are 1816 to 1835. For the purposes of this paper the leading events may be very briefly summarized.

Though foreign trade declined rapidly after 1816, customs revenues were in the main more than sufficient to meet government expenditures. The evils of redundant income were avoided by the rapid payment of the public debt. Unfavorable industrial conditions, however, in this manufacturing era, as in the commercial and war periods preceding, rendered the revenue extremely

uncertain. Especially in the crises of 1819 and 1824 the income, as shown in Chart I., fluctuated abruptly and widely about government needs. During the earlier crisis these fluctuations were almost as marked as those of the foreign war period. Chart I. shows the cause. Imports which had risen in 1818 to \$102,323,000, fell successively, through 1819, 1820, and 1821 to \$67,959,000, \$56,441,000, and \$43,696,000 respectively. Customs revenues consequently decreased, falling from \$20,283,000, in 1819, to \$15,005,000, in 1820, and \$13,004,000 in 1821. Nor did the income fully recover until after the crisis of 1824. The serious effect upon the treasury of this unexpected decrease of revenue is shown by the following extract from the report of the Secretary for 1819: "It is not probable that any modification of the existing tariff can supersede the necessity of resorting to internal taxation if the expenditure is not diminished. . . . Whether the revenue be augmented or expenditure be diminished a loan to some extent will be necessary."¹ Yet the revenue was ordinarily redundant and two years before had been 31.4 per cent. greater than the government expenditures, and further, this was in a time of peace and average prosperity, when, if ever, the income should have proved adequate. However, from the crisis of 1824 to the end of this period in 1835 little criticism can be made of the revenue system. Imports rose rapidly, and the income from customs duties continued to be for the most part far above the current government expenditures. Though this was in direct violation of the rule of sufficiency it furnished a welcome means of debt payment, and the period closed with confidence in this source of revenue unshaken.

4. Between 1835 and 1843 a brief period of unhealthy speculative expansion, and the inevitably painful return to normal conditions, succeeded the vigorous growth of the preceding years. The national debt was practically liquidated at the close of the year 1835, and the speculative spirit which developed was undoubtedly due in great part to surplus revenue no longer to be disposed of by debt payment. This surplus accumulated mainly

¹ *Report of the Secretary of the Treasury* (Crawford), *Finance Reports*, vol. ii. p. 149.

through excessive sales of public lands, added to the ordinary customs tax income.¹

An unappropriated surplus is always a greater financial evil than a moderate deficit, since it so far unnecessarily reduces the income of the people and leads to false estimates of the tax-paying capacity of the nation. At this time, therefore, the income from a legitimate system of taxation, through its elasticity, should have declined so that the total government income might meet exactly the demands of ordinary public expenditures. It was not so with the income from the Customs Tax system. Though the Secretary of the Treasury recognized the danger and repeatedly endeavored to bring about a reduction in the tax income, the revenue from customs during the years of speculation rapidly increased (see Chart I.), rising from \$16,214,000, in 1834, to \$19,391,000, in 1835, and \$23,409,000, in 1836. The ridiculous spectacle was presented of a sovereign people taxing themselves far beyond the needs of the government and yet wholly unable to obtain relief, while a growing surplus was becoming more and more a source of anxiety. At last, in June, 1836, the reduction of the revenue being out of question, Congress passed an act for the disposal of the surplus. It ordered the distribution of \$28,000,000 among the States in the form of quarterly payments beginning January 1, 1837. Before the last deposit was made the aspect of affairs was entirely changed. Over-speculation had precipitated the crisis of 1837. The sale of public lands ceased. Government income at once fell from forty-eight to nineteen millions. The same secretary, who, a year before, had urged a reduction of income now spoke dolefully of a prospective deficit at the beginning of 1838 of over five millions. The need now was for an immediate increase of the tax revenue. But the income from the customs tax system instead of rising to meet this need dropped from \$23,409,000 to \$11,169,000. A glance

¹“The great surplus forced into the Treasury by the excesses in the sales of land and in duties on imports . . . has undoubtedly contributed, through the loan of it while on deposit, to sustain, in some degree, if not to produce the spirit of overtrading.”—*Report of the Secretary of the Treasury* (Woodbury), 1837, *Finance Reports*, vol. iv. p. 29.

at Chart II. will best indicate the state of affairs. Though two years before, when the Treasury was overflowing with income from an incidental source, import duties had furnished 10.3 per cent. more than the total needs of the government, they now brought in less than 30 per cent. of necessary government expenditures. Secretary Woodbury, commenting upon the situation, said: "It is impossible, . . . that, with sources of revenue so fluctuating as ours, and so dependent on commercial prosperity, any fiscal operations should be long continued with ease, vigor, and uniformity, without some such regulator as a power to issue and redeem Treasury notes, or to invest and sell the investment of surpluses. By any other course we should constantly be exposed to great deficiencies or excesses with all their attendant embarrassments."¹

Frequent though less severe fluctuations in the customs revenue continued in the troubled years succeeding the crisis, nor did it again meet government demands till after the close of the period in 1843. This condition of affairs called forth from the Secretary in 1839 the following complaint: "The principal sources of our revenue are sensibly affected by fluctuations, not only in commercial prosperity, but in the crops, the banking policy and the credit systems of even foreign nations. The influence of these causes seems to become yearly more changeable and uncertain in its extent."² National finances in consequence were most seriously affected. It was found necessary to create a new national debt. Two loans and five issues of treasury notes were resorted to between 1837 and 1843, while the credit of the government "stood at a lower ebb than ever before in times of peace."³ The examination of this period of speculative expansion and collapse furnishes them a double exhibition of utter inflexibility of the customs tax system when it should have been most flexible and of extreme sensitiveness to changes in commer-

¹ *Report of the Secretary of the Treasury, 1837, Finance Reports, vol. iv. p. 9.*

² *Report of the Secretary of the Treasury (Woodbury), 1839, Finance Reports, vol. iv. p. 242.*

³ SCHOULER, *History of the United States*, vol. iv. p. 408.

cial and industrial conditions, when it should have been most stable.

5. The two decades following 1843 form another period of vigorous national growth accompanied by remarkable commercial activity. Reference to Chart I. shows the rapid and enormous increase of foreign trade. Imports rose from \$96,390,000 in 1844 to \$336,282,000 in 1860. Mr. Walker speaks of 1846 as beginning a "new commercial era" in which "many causes combined to augment the trade among nations."¹ The Mexican war and the crisis of 1857 were the only events which, in 20 years, seriously interfered with industrial prosperity. The demands of the government were at no time beyond the revenue that could have been obtained from legitimate taxation, while more than ordinary efforts were made to bring the tax income into exact conformity with public expenditures. A most favorable opportunity therefore existed to test the adequacy of the customs revenue system.

The financial history of the period, however, while it reveals a closer conformity of the tax income to the demands of the government than previously does not present the customs system in a favorable light. A high rate of specific duties had been levied in 1842 to enable the income to recover from the effects of the crisis of 1837. The first result was an increase considerably beyond government needs. By 1845 customs duties were producing 19.4 per cent. more revenue than was called for by public expenditures. Then, though imports continued to increase, the income began seriously to decline. Mr. Walker, Secretary of the Treasury, declared that this decline "rose from the prohibitory character of specific duties," and that "the revenue under the tariff of 1842 must have continued to sink so rapidly as soon to have caused a great deficit, even though in time of peace, and thus have required ultimately a resort to direct taxes or excises."²

As high specific duties had failed to produce adequate revenues, the Secretary proposed a reduction, with *ad valorem*

¹ *Report of the Secretary of the Treasury* (Walker), 1847. *Finance Reports*, vol. vi. p. 149.

² *Report of the Secretary of the Treasury*, 1846. *Finance Reports*, vol. vi. p. 6.

duties. Congress therefore enacted a revenue law along these lines, designed to aid in vigorously carrying on the war with Mexico. But though the revenue from customs was thus increased, it fell far short of satisfying government needs during and immediately following the war. Only 43.2 per cent. of the necessary public income was received from such taxation in 1847, 66.6 per cent. in 1848, and 65 per cent. in 1849. With the year 1850, however, the income began to increase rapidly,¹ and by 1853 "a large surplus accumulated in the treasury and became a cause of alarm in commercial circles."² Expenditures increased, but still the surplus grew. Alarm was felt that the accumulation of specie in the treasury might bring on financial stringency.³ An act was therefore passed, in 1857, reducing customs duties. This attempt to bring about an equilibrium of income and expenditure, like previous efforts, miscarried. It was impossible to reckon on the certainty of customs revenues. The crisis of 1857 brought with it an immediate fall in the tax income of over \$22,000,000. Before the end of the year 1857 Congress was obliged to authorize an issue of \$23,716,300 in treasury notes and six months later to place a loan of \$10,000,000. During the remainder of this period the receipts remained inadequate, exhibiting extreme sensitiveness to the political movements preceding the civil war. A threatened revolution of a political character late in 1860 drew the following complaint from the Secretary of the Treasury: "Already has the treasury been seriously affected by these causes. The receipts from customs for the last few days have greatly fallen off, and the limited amount received is composed each day of an increased proportion of treasury notes not yet due."⁴ Thus with an income insufficient even in time of peace

¹Not so rapidly as appears from the tables (see Appendix I.). Before 1850 customs revenues are net—after 1850 gross.

²*Report of the Secretary of the Treasury* (Guthrie), 1853, p. 6.

³See Young's *Special Report on Customs Tariff Legislation*, XLII. Congress, 2d Session, p. 107.

⁴*Report of the Secretary of the Treasury* (Cobb), 1860, p. 7. The Secretary was so alarmed that he recommended an issue of treasury notes, for the redemption of which the public lands should be unconditionally pledged.

and prosperity, the country entered upon a period of civil war.

6. Though on a vastly greater scale, the financial conditions and results of the civil war were quite similar in character to those of the war of 1812. A very brief discussion of the later period will therefore suffice for the purposes of this paper. If, in the civil war, as in the war of 1812, the income from customs duties be contrasted with government expenditures, the result is even more unfavorable to this form of revenue. This is readily seen by a glance at Chart II. and by a comparison of the following tables :

WAR OF 1812.

YEAR.	Government Expenditures. (,000 omitted)	Customs Revenues. (,000 omitted)	Per cent. of Customs Revenues to Government Expenditures.	Value of Imports. (,000 omitted)
1810.....	\$ 8,474	\$ 8,583	101.2	\$ 61,008
1811.....	8,178	13,313	162.7	37,377
1812.....	20,280	8,958	44.1	68,534
1813.....	31,681	13,224	41.4	19,157
1814.....	34,720	5,998	17.2	12,819
1815.....	32,943	7,282	22.1	10,645
1816.....	32,196	36,306	112.7	129,964
1817.....	19,990	26,283	131.4	79,891

CIVIL WAR.

YEAR.	Government Expenditures. (,000 omitted)	Customs Revenues. (,000 omitted)	Per cent. of Customs Revenues to Government Expenditures.	Value of Imports. (,000 omitted)
1860.....	\$ 63,200	\$ 53,187	84.1	\$336,282
1861.....	66,650	39,582	59.3	274,656
1862.....	469,570	49,056	10.4	178,330
1863.....	718,734	69,059	9.6	225,375
1864.....	864,969	102,316	11.8	301,113
1865.....	1,296,817	84,928	6.5	209,656
1866.....	523,565	179,046	32.2	423,470
1867.....	357,542	176,417	49.3	378,158
1868.....	377,340	164,464	43.5	344,808
1869.....	322,865	180,048	55.7	394,440

In the civil war, however, as in the war of 1812, it was believed to be impossible to obtain the whole of the necessary

government revenues by means of taxation. The financial plan of the war, as detailed by the Secretary of the Treasury, provided that the bulk of extraordinary income should be drawn from loans, taxation being relied upon to furnish only the means for the discharge of the ordinary demands, for the punctual payment of interest on loans, and for the creation of a gradually increasing fund for the reduction of the principal.¹ Such a tax revenue, it was confidently expected, would maintain the credit of the nation unimpaired. "The preference always evinced by the people of the United States, as well as their legislature and executive, for duties on imports" determined the secretary, when making provision for the necessary tax income, to recommend only such modifications of the existing tariff as would produce the principal part of the needed revenue, and such resort to direct taxes or internal revenue duties or excises as circumstances might require in order to make good whatever deficiency might be found to exist.² Customs duties were then distinctly regarded as the war taxes, and the success of the war policy is the test of their adequacy.

From the beginning of the struggle the capacity of the customs revenue system was strained to the utmost. Additional import duties were imposed during the extra session of Congress in summer of 1861. A further increase was made in December, soon after the next regular session had convened, and "from that time till 1865 no session, indeed, hardly a month of any session passed in which some increase of duties on imports was not made."³ The results were ridiculously meager. For the years 1861-62-63 the revenue remained almost absolutely inflexible, scarcely rising above the ordinary peace level. As early as 1863 Secretary Chase was forced to admit the failure of the policy of relying on customs revenues. In his report he said: "It is possible that a limited additional amount of income may be derived from judicious modifications

¹ *Report of the Secretary of the Treasury*, July 4, 1861, p. 6.

² *Report of the Secretary of the Treasury*, July 4, 1861, p. 7.

³ TAUSSIG, *Tariff History*, p. 160.

of some provisions of the laws imposing duties on foreign imports, but the chief reliance for any substantial increase, and even for the prevention of possible decrease, must be on internal duties." Nevertheless a supreme effort was made in the great act of 1864 to bring about a substantial increase in the customs revenue. Imports were universally taxed, and at the highest rates that Congress dared impose. The result was disappointing, and was a remarkable illustration, both of the inflexibility and the instability of the customs system. The excessive rates caused an immediate reduction of imports, and, instead of an increase, there was a fall in the amount of customs revenue, for 1865, of more than seventeen millions of dollars.

In consequence of the meager income from taxation, the credit of the government early began to decline. Though all loans were nominally placed at not less than par, it was par in depreciated paper currency. The following table¹ exhibits the rapid fall of public credit by showing the specie price of all obligations issued during the war :

FOR THE YEARS ENDING	Gross Receipts from Debts created.	Gold Value of Gross Receipts.	Percentage Realized.
December 31, 1862.....	\$470,562,306	\$420,657,784	89.39
" 31, 1863.....	663,748,162	451,687,251	68.05
" 31, 1864.....	754,938,393	384,462,432	50.93
September 30, 1865.....	675,984,729	438,540,163	64.87

The spectacle of a powerful and wealthy nation placing its loans at a discount of almost 50 per cent. is strong evidence against its system of taxation.

Though condemned by the failure of the war policy the actual inferiority exhibited by the customs system in this emergency, can be best shown by a comparison of the revenue received from it with that derived from internal revenue duties. The internal revenue system was only gradually put in operation after the beginning of the war, and first became productive in 1863. In the next three years, however, \$628,436,000 were covered into the treasury from this source as against \$336,290,000 from

¹ H. C. ADAMS, *Public Debts*, p. 131.

the customs tax system pushed to its greatest capacity.¹ At the period of greatest stress, when the revenue from customs duties stood absolutely inflexible, the revenue from internal duties, though already greater than that from imports, was made to increase \$100,000,000 in a single year. Further, while the income from customs was extremely uncertain, the flow of revenue from internal duties was a steadily rising stream, increasing from \$109,000,000 in 1864 to \$209,000,000 in 1865, and \$309,000,000 in 1866. It is true, indeed, that after the stress of war was passed, customs duties furnished an enormously increased revenue, but quickness of response to financial measures is an absolute essential to adequacy. Here lay the chief merit of the internal revenue system. Its manifest superiority over the customs system goes only to confirm the conclusions reached by the comparison of the two systems in the war of 1812. It is probable, as H. C. Adams suggests,² that had the internal revenue machinery been in operation two years earlier the war might have been brought to a more speedy termination, while the credit of the government could not have suffered as it did.

¹ Allowance must be made, however, for the fact that internal revenue duties were payable in depreciated paper currency.

² *Public Debts*, p. 132. The following table indicates how a setting forward of the internal revenue receipts two years would have affected the combined income from the two systems:

ACTUAL REVENUE.

YEAR.	1862.	1863.	1864.	1865.
Customs revenue....	\$49,000,000	\$69,000,000	\$102,300,000	\$84,900,000
Internal revenue....	37,600,000	109,700,000	209,400,000
Total.....	\$49,000,000	\$106,600,000	\$212,000,000	\$294,300,000

SUPPOSITIONAL REVENUE.

YEAR.	1862.	1863.	1864.	1865.
Customs revenue....	\$49,000,000	\$69,000,000	\$102,300,000	\$84,900,000
Internal revenue....	109,700,000	209,400,000	309,200,000	266,000,000
Total.....	\$158,700,000	\$278,400,000	\$411,500,000	\$350,900,000

7. The civil war period financially considered closed about the year 1869, when the government ceased to borrow to satisfy the demands incurred on account of the war. The succeeding years down to the present time form a period in which the general conditions were nearly the same in character as those following the war of 1812. In this as in the former period, commercial, industrial and national expansion followed the war; in this period also these manifestations of growth were accompanied by serious industrial disturbances; in both periods a great national debt was saddled on the government. The financial history of the two periods is, naturally, quite similar. One great difference however exists. The internal revenue duties, which were abolished as soon as possible after the war of 1812, were, in the later period, in part retained. From them the government has received a fairly steady and abundant revenue in addition to the income from customs duties. This fact may perhaps be taken as cause for denying the possibility of testing, by means of the fiscal criteria, the adequacy in this period of the customs revenue system. But the objection seems really without foundation. Customs duties are still regarded as the traditional, national system of taxation. They are only supplemented by the internal duties; but this fact is, in itself, highly significant. That it has been deemed necessary in recent years thus to bolster up the customs system is, *per se*, one of the strongest proofs of the failure of that system to serve as an adequate source of national revenue. It will be admitted however that the employment of the internal duties does render a direct comparison between customs revenues and public expenditures useless for the purposes of this paper. Yet a brief survey of the period is of great value to bring out two points—the over-abundance and inflexibility—of customs revenues in a period of general prosperity, and, at the same time the extreme instability of the income from this source.

At the beginning of this period speculative activity grew rapidly, commerce was greatly stimulated, and the tax income was in consequence remarkably large. As early as 1870, the

revenue was more than \$100,000,000 greater than current public expenditures, and the next year the excess was nearly as great. The public debt, though payments were made rapidly, could not absorb so great a surplus. It became a menace to the prosperity of the nation. An immediate reduction of taxation was therefore called for, and in 1872 a reduction of 10 per cent. in the rate of customs duties was effected. But on account of the instability of the revenue the step proved disastrous. Crisis and industrial depression almost immediately followed, and both imports and customs duties were suddenly and extensively decreased. Imports fell nearly \$100,000,000 in a single year and did not rise again to their normal volume until 1880. The revenue from customs which had stood at \$216,370,000 in 1872 dropped to \$188,089,000 in 1873 and \$163,103,000 in 1874. Then it became necessary for the government, which but three years before was contending with a \$100,000,000 annual surplus, to resort to borrowing. In alarm, Congress, in 1875, restored the 10 per cent. which had been taken from the rates of customs duties in 1872. But the revenue system which had proved so sensitive to commercial changes, did not respond to the efforts of the government. The fall in the value of customs revenues continued until in 1878 it was \$86,000,000 less than five years before.

The revival of trade however which came about 1879, soon carried customs revenues to a higher point than ever before. By 1881, the Secretary of the Treasury was again complaining of an embarrassing surplus revenue.¹ This was estimated, in 1883, at \$85,000,000 per annum,² and in 1886 Secretary Manning reported that during the last years the surplus had averaged over \$100,000,000.³ How to dispose of the immense hoard in the Treasury became again the great financial problem. Congress had risked revenue reduction with disastrous results. It

¹ *Report of the Secretary of the Treasury* (Manning), 1886, p. xxxiv.

² *Report of the Secretary of the Treasury* (Folger), 1883, p. xlv.

³ *Report of the Secretary of the Treasury* (Folger), 1881, p. xviii.

dared not again adopt this means of avoiding surplus. Naturally,¹ therefore, it now resorted to the other alternative—extravagant expenditure. By means of enormous appropriations the surplus was soon depleted. But here again Congress had failed to take sufficient account of the instability of the customs revenue system. The crisis of 1890 was at hand; the revenue from customs fell rapidly; a deficit resulted, and the government has again been forced in a time of peace to make use of its credit. Thus the nation is repeating, apparently in the same order as before the financial experiences of the earlier part of the period, and the dreary alternative of embarrassing surplus and embarrassing deficit bids fair to continue as long as the present revenue system exists.

The direct historical examination of the customs revenue system, in connection with the fiscal criteria previously laid down, has now been completed. This examination has extended over the whole experience of the United States, in the use of the customs revenue system as a national source of income. No period therefore remains whose events may contradict the conclusions drawn from this study so far as they relate to American financial history. It will be well, briefly to sum up the results of this discussion.

In the historical survey a variety of national, industrial and commercial conditions have been encountered, yet the testimony throughout is strikingly in accord. In the first period examined, while the nation was yet in its youth, and subject to strong foreign influences, the customs revenue, though on the whole abundant, was found to be uncertain to such an extent as rendered it an extremely precarious base on which to place the public finances. In the second period, under the stress of foreign war, the financial policy based upon the customs revenue system utterly broke down, as a result of the insufficiency and inelasticity of this form of income. The generally favorable

¹ As Secretary Cobb has said: "When public revenues *happen* to be abundant, many projects are listened to and adopted by Congress, without careful regard to the burdens they may permanently impose".—*Report of the Secretary of the Treasury*, 1857, p. 10.

conditions of the third period, while accompanied by a redundancy of revenue, did not insure the nation against great instability of income, resulting from transient industrial disturbances. The fourth period under examination, furnished a striking illustration of redundant customs revenue both as effect and cause of speculative expansion, and of the extreme instability of this form of revenue in time of acute commercial crisis. In the fifth period, under remarkably favorable general circumstances, the customs revenue, though on the whole abundant, still proved extremely sensitive to industrial and commercial disturbances. The civil war period served only to illustrate on a larger scale the defects of the system that were found to characterize it in the war of 1812. And finally, in the full vigor of the nation, and in time of average prosperity, this form of revenue was found to be alternately, according to the transient character of industrial and commercial conditions, greatly in excess of and far beneath the income necessary for the support of the financial operations of the government.

It will be seen that two factors are common to all these periods, viz., redundancy of revenue in time of commercial and industrial activity, and insufficiency and instability of revenue in time of stress and depression. On the whole it may be asserted, without fear of contradiction, that, throughout the history of the customs revenue system in the United States, the income from this source has been determined, not by government need, but, almost wholly, by the character of temporary industrial, and, more especially temporary commercial conditions. As a consequence, in war the current public income has proved utterly insufficient, unstable and inflexible; in peace it has shown itself extremely uncertain fluctuating with every crisis and even with the changes in the policy and condition of foreign nations; in times of prosperity it has forced upon the treasury embarrassing surpluses, leading to extravagant expenditure, speculation and crisis; in adversity it has left the treasury empty, necessitating the lavish use of the public credit. Judged purely by these results, as a main source of national income, customs duties must receive almost unqualified

censure, compared with which the aspersions against it as a cause of individual injustice are trivial, and it should at once be discarded or essentially modified. However, the foregoing discussion has not been exhaustive enough to justify the rendering of a general verdict. The questions, whether any peculiar circumstances have accompanied the employment of the customs revenue system in the United States, and if so, whether, and to what extent, these circumstances, non-inherent to the use of the customs revenue system, have contributed to its unfavorable showing are still before us. These questions will be discussed as briefly as possible in the following section.

III.

A review of the general conditions existing in the United States since customs duties first became the national revenue system reveals no peculiar circumstances operating against the successful employment of this source of public income. On the contrary, the general conditions have been remarkably favorable. Vigorous national growth, rapid industrial and commercial expansion, and great accumulation of wealth, have characterized the period. The isolated position of the country and a conservative attitude toward government enterprises, have combined to render national expenditures on the whole moderate. Customs duties, moreover, have been used to provide only for Federal expenditures, the states being expressly forbidden by the Constitution from placing any duties on imports. And finally, the people, upon whose approval the success of any system of taxation under a democratic government must ultimately depend, have regarded indirect taxes with peculiar favor. The failure, then, of the customs revenue system to conform to the requirements of fiscal adequacy cannot be regarded as a result of the general conditions found in the United States in the past century. This conclusion granted, there remains but one other possible source from which circumstances might arise unfavorable to the success of the system, viz., the financial operations of the government. Here, indeed, two peculiar and unsatisfactory features

are found to exist. They are, first, a faulty financial organization; and secondly, a continued administration of the customs revenue system for economic rather than fiscal purposes. That these features of American finance have been responsible, to some extent at least, for the unfavorable showing of the customs revenue system in the United States cannot be questioned. How far they have contributed to its failure is the vital problem before us. Whether the customs system must indeed, as indicated by the historical examination, be regarded as essentially incapable of serving as an adequate source of national income, or whether it may be modified or administered in such a manner as to avoid the difficulties of the past, are questions that depend for answer upon a solution of this problem. The peculiarities of American financial operations are, in general, such as to make it difficult to draw any detailed inferences from the history of our finances. Each of these unfavorable features connected with the customs revenue system, therefore, requires careful examination in order that its effect upon the workings of that system may be fully appreciated.

The particular feature of our financial organization that has unfavorably affected the customs revenue system is a division of powers and responsibilities in the construction of the national budget. There is in our government no single eye that surveys and no single responsible head that dominates the budgetary operations. The financial estimates are, indeed, prepared under the supervision of one person—the Secretary of the Treasury. But this operation completed, his power and his responsibility pass over into the hands of the legislature.¹ There is a positive line of separation between the executive and legislative departments. The Secretary of the Treasury may recommend, but he cannot enter the legislative chamber to explain or defend his position. Congress has unlimited power to add to, or take from the

¹ “The executive power is responsible for a correct construction of the existing laws and an honest application of the funds placed by Congress at its disposal, in the execution of the laws, and for the objects for which appropriations are made.”—*Report of the Secretary of the Treasury* (Guthrie), 1856, p. 19.

estimates and to establish whatever taxation it may deem proper. The financial measures therefore, in fact, come from the legislature itself. But even in the legislature, working by means of committees, expenditure and taxation are not considered together as forming one problem, and further, Congress is composed of many individuals, with widely differing financial abilities, influenced mainly by other than financial motives.¹ "The consequence is the loss of all unity of plan and a failure almost every year to approach equilibrium."² It can readily be seen how this results in apparent inadequacy of the customs revenue system. If the estimates are not in equilibrium, it is impossible that the expenditures and income should coincide in amount. When interested congressmen secure additional appropriations for the satisfaction of their constituents, and yet dare not impose additional rates of taxation,² insufficient revenue is the inevitable result, and this appears, in a simple historical examination of the results attained by the use of the customs revenue system, as a violation of the criterion of sufficiency. Great care, then, must be exercised in determining the inherent adequacy of the customs system to make proper allowance for failure resulting from defective construction of the annual budget.

The second peculiar feature of American financial operations, is the predominance of the protective idea in the shaping of the revenue system itself. The attempt to foster home industry by means of high duties on imported merchandise is not, of course, a novel feature of financial legislation, but in the United States fiscal considerations have been pretty systematically subordinated to the protective aim. This result has been due mainly to three causes: first, the faulty financial organization already discussed, which places fiscal management in the hands of men dominated, to a great extent by political and economic motives; secondly, the great wealth of the country, which, rendering public borrow-

¹ "Members of Congress are more interested in securing expenditure desired by their constituents than in maintaining the character of the National Finances."—C. F. BASTABLE, *Public Finance*, p. 661.

² C. F. BASTABLE, *Public Finance*, p. 660.

ing easy, and enabling the nation to recover rapidly from the effects of financial blunders, has veiled the real importance of fiscal considerations, and thirdly, the presence, during almost eighty years of our national history, of a public debt readily absorbing surplus revenues. To what an extent, aided by these causes, protective considerations have been a dominant factor in our financial affairs a very brief resumé of events will sufficiently indicate. The protective idea was earnestly discussed in the first session of the first congress and influenced the tariff act of 1789. The question then fell out of sight, however, until 1816. At that time it reappeared as a plea for protection to infant industries and, with the exception of the period between 1842 and the end of the civil war, has been the main consideration in financial legislation. Since 1816 it has played two distinct rôles, in each of which it has thrown questions of a fiscal character entirely into the background. In 1828 its consideration developed into a bitter sectional struggle, producing a tariff that "was a complex of compromises, and bore upon its face evidences of the notorious fact that it was a product of a selfish contest between several sections of the country for an economic advantage,"¹ while, since the civil war, its discussion has degenerated into a partisan political strife, in the heat of which the fiscal purposes of the tariff are practically overlooked by the protective party. This predominance of the protective idea has unfavorably affected the adequacy of the revenue system both in the choice of articles taxed and in the rate of taxation imposed. Articles of steady consumption, the revenue from which possesses both stability and flexibility, have largely been placed upon the free list, while the revenue has been drawn mainly from sources easily affected by business depression and commercial crises. The rates of taxation, moreover, have been imposed with little reference to the question of productiveness, but rather with the distinct idea of discouraging importations. In short Congress has regarded the immense resources of the nation as license for the neglect of the most elementary rules of practical financial legis-

¹ WOODROW WILSON, *Division and Reunion (Epochs of American History)*, p. 48.

lation, and in consequence, both the stability and flexibility of the revenue system have been disastrously impaired.

The discussion then, of the defective budgetary supervision, and of the subordination of fiscal considerations to protective aims, in financial operations of the United States, has established the fact that these two causes have entered as factors, into the unfavorable showing of the customs revenue system, with respect to all three of the fiscal criteria—sufficiency, flexibility, and stability. Unless, therefore, some method is devised by which to eliminate the results arising from these causes no broad general conclusion can be reached with regard to the fiscal adequacy of the customs system. Such elimination can, in fact, be only partially accomplished, but enough can be said to prove that while these causes have produced a great part of the inadequacy displayed by the revenue system, still that system, through inherent defects, is a most precarious source of public revenue.

Defective budgetary supervision has been a constant factor, modifying, from the beginning of our history, the sufficiency of the revenue system. There seems to be no method by which its results can be exactly determined. It is a suggestive fact, however, that in the time of Hamilton and Gallatin, the two Secretaries of the Treasury that have approached most nearly to the position of real finance ministers, the revenue from customs duties corresponded no more closely to the amount of government expenditures than in the later periods of our history (see Chart III.). Turning then to the consideration of the other cause of the inadequacy—the dominance of the protective idea—there are to be found at least two methods by which its results may, to some extent, be determined. These are by appeal to the experience of other countries in the use of the customs revenue system, and by a comparison of the revenue results obtained in different periods of our own history. Applying the first of these methods, it is particularly instructive to note the experience of England. By a careful selection of articles for taxation, and by the imposition of rates mainly with

a view to productiveness, England has been enabled to secure from customs duties a remarkably steady flow of revenue, in spite of business depressions and commercial crises. The following table from the *Statistical Abstract of the United Kingdom* shows the revenue derived from customs duties during the years 1869-1892:

ENGLISH CUSTOMS REVENUE.

Year.	Customs Revenue.	Year.	Customs Revenue.	Year.	Customs Revenue.
1869.....	£22,424	1877.....	£19,922	1885.....	£20,321
1870.....	21,529	1878.....	19,969	1886.....	19,827
1871.....	20,191	1879.....	20,316	1887.....	20,155
1872.....	20,326	1880.....	19,326	1888.....	19,630
1873.....	21,033	1881.....	19,184	1889.....	20,067
1874.....	20,339	1882.....	19,287	1890.....	20,424
1875.....	19,289	1883.....	19,657	1891.....	19,480
1876.....	20,020	1884.....	19,701	1892.....	19,736

It is to be noted that neither the crisis of 1873, nor the period of depression following it, nor the acute crisis of 1890 affected seriously the flow of the revenues. The direct inference drawn from these figures would then be that the instability displayed by our revenue system has been almost wholly due to defects in its administration. But it must be remembered that customs duties are a comparatively small element in the English revenue system. The number of articles taxed is limited. Therefore, those articles only need be used whose income is least liable to fluctuation. In a country, on the other hand, where customs duties form the main reliance of the government no such nice choice of articles can be made. To a great extent those of unsteady consumption must be employed with those of steady consumption, and the revenue will fluctuate accordingly.

Further, the direct inference from English experience seems to be contradicted by a comparison of the results attained in the various periods during which the customs revenue system has been in use in the United States. In all these periods, including the first and second (1789-1816), when the protective idea was

almost entirely absent, and also the fifth and sixth (1843-1868), when it was subordinated to fiscal considerations, unpardonable instability and inflexibility of the revenues are constantly present. But the instability and inflexibility displayed in these non-protective periods cannot be considered due either to defective budgetary supervision, for that effected only the sufficiency of the revenue, or to the element of protection, for that was in subordination. Yet an examination of the charts will fail to disclose that during these periods the fluctuations of the customs revenue were perceptibly less than in the distinctively protective periods. They must then be regarded as manifestations of grave inherent defects in the customs system. It is true that the non-protective periods include the wars of 1812 and 1862, also the period of strong foreign influence in our national affairs, together with the crisis of 1857—all times of special stress. It would then appear, that while it cannot be denied that the failure of the customs revenue system to conform to public expenditures may be wholly due to defective financial operations, and while its instability and inflexibility under ordinary circumstances may be accounted for by the prominence of the protective idea, still the experience of the United States may be taken to prove that the customs revenue system, through inherent inflexibility and instability, is incapable of serving as an adequate source of public revenue in times of emergency. But is it not just in times of emergency that the real strength of a revenue system is tested? No nation could be found willing to base its finances on a system that must fail it in time of stress. This conclusion then is really equivalent to a general condemnation of the customs revenue system as the main source of a national income.

The discussion of the peculiar circumstances affecting the customs revenue system in the United States has, then, considerably modified the broad general conclusion drawn purely from the historical examination. But, though the scope of the general conclusion has been narrowed, and has been rendered also somewhat equivocal, this discussion serves only to confirm in all its

force the practical conclusion that the customs revenue system should be either discarded or essentially modified. It has shown that not only is the revenue system in itself essentially faulty but that the incidental causes of its inefficiency in the United States lie too deep in the structure of our government and in the character of our people to be easily eradicated. It will take much time to displace the financial methods sanctioned by a century of use, and still longer to convince the people that the tariff is not essentially bound up with the protective policy. It may be assumed then that the results to be derived from the continued use of this revenue system will be as unsatisfactory in the future as in the past. But the effect upon the prosperity of the nation cannot but be even more disastrous. As we approach European conditions, industrial enterprise becomes more sensitive and our ability to recover rapidly and easily from the effects of financial blunders grows less. The events of the past three or four years should serve as a warning of this fact and might teach us that it is time to put aside the consideration of the problematical justice or injustice of the customs revenue system and turn our attention to the vital questions of its modification and better administration. It is imperative that the national revenue system in itself be made more flexible and more stable. It is for us to consider carefully what measures, whether the introduction of the income tax, or the extension of the internal revenue duties, will bring about these results.

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